



***FINANCIAL SECTION  
AUDITOR'S REPORTS***



## UNITED STATES RAILROAD RETIREMENT BOARD

### OFFICE OF INSPECTOR GENERAL

To the Board Members:

The following report presents the results of the Office of Inspector General's (OIG) audits of the financial statements of the Railroad Retirement Board (RRB) as of and for the fiscal years ended September 30, 2009 and 2008.

### **OPINION ON THE FINANCIAL STATEMENTS**

We have audited the accompanying balance sheet of the RRB as of September 30, 2009 and 2008; the related statements of net cost, changes in net position, and budgetary resources for the years then ended; and the statements of social insurance as of January 1, 2009, 2008, 2007, and 2006.

We did not audit the financial statements of the National Railroad Retirement Investment Trust (NRRIT). The net assets of the NRRIT represent approximately 80% and 82% of the total assets reported by the RRB for fiscal years 2009 and 2008, respectively. NRRIT assets represent approximately 95% and 97% of the reported railroad retirement program's social insurance fund balance as of January 1, 2009 and 2008. Related changes in the net value of investments held by the NRRIT are reported as a source of financing which contributed net losses of approximately \$2 billion and \$7.3 billion during FY 2009 and FY 2008 respectively.

Pursuant to the Railroad Retirement and Survivors' Improvement Act of 2001, the NRRIT retains the services of an independent auditor to opine on its financial statements. With respect to the assets of the NRRIT as of September 30, 2009 and 2008; and January 1, 2009, 2008, 2007, and 2006, the financial statements of the NRRIT were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for the NRRIT, is based solely on the report of the other auditors.

In our opinion, the financial statements of the RRB referred to above, including the accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, the financial position of the RRB, its consolidated net cost of operations and changes in net position, and combined budgetary resources as of and for the fiscal years ended September 30, 2009, and 2008; and the financial condition of the Railroad Retirement program as of January 1, 2009, 2008, 2007, and 2006.

However, misstatements may nevertheless occur in other financial information reported by the RRB and may not be detected as a result of internal control deficiencies described later in this report.

**Social Insurance**

As described in the statement and related notes, the statement of social insurance presents the actuarial present value of the future income to be received, and expenditures to be paid to or on behalf of participants in the Railroad Retirement program during a period sufficient to illustrate the program's long-term sustainability. In preparing the statement of social insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statement. However, because of the large number of factors that affect the statement of social insurance and the fact that future events and circumstances cannot be known with certainty, there will be differences between the estimates in the statement of social insurance and the actual results, and those differences may be material.

The RRB's statement of social insurance presents the fund balance of the Railroad Retirement program and the related estimate of actuarial surplus which is computed by adding the fund balance to the estimated excess (or shortfall) of the present value of future income over the present value of future expenditures for the 75 year projection period. These additional line items are presented to ensure that a reader would not be misled about the financial condition of the program. The program's current financing structure creates an inverse relationship between income and program assets; thus, the financial condition of the program cannot be understood without direct reference to the fund balance and the related actuarial surplus or deficiency. This relationship is disclosed in Note 15 to the financial statements.

**Emphasis of Matters***NRRIT*

Pursuant to the Railroad Retirement and Survivors' Improvement Act of 2001, the NRRIT is authorized to invest railroad retirement assets in a diversified investment portfolio. As of September 30, 2009, the reported value of the net assets of the NRRIT was approximately \$2 billion lower than reported at September 30, 2008. The RRB discusses its relationship with the NRRIT in Note 2 and Note 5 to the financial statements, and describes the impact of changes in the social insurance fund balance on actuarial projections in Note 15.

*Financial Interchange*

The RRB discloses transactions with related parties in Note 2 to the financial statements. The RRB, Social Security Administration and Centers for Medicare and Medicaid Services are parties to a financing arrangement described as a financial interchange. Under this arrangement, transfers-in from the Social Security Administration's Old-Age and Survivors Insurance and Disability Insurance trust funds and transfers-out to the Federal Health Insurance trust fund

represented approximately \$4.0 billion (net), or about 37% of the financing sources reported on the RRB's statement of changes in net positions for FY 2009 before considering the reduction in the reported value of NRRIT assets. For FY 2008, financial interchange transfers of \$3.6 billion (net) represented about 35% of the financing sources before considering the reduction in the reported value of NRRIT assets.

## CONSIDERATION OF INTERNAL CONTROL

In planning and performing our audit, we considered the RRB's internal control over financial reporting and compliance.<sup>1</sup> We did this to determine our procedures for auditing the financial statements and to comply with OMB audit guidance, and not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance or on management's assertion on internal control included in Management's Discussion and Analysis.

With respect to previously reported control deficiencies, the RRB has made progress strengthening its information security program but this effort is not yet complete and remains an area of material weakness.<sup>2</sup> Although the agency has implemented additional procedures to improve controls over financial reporting, these changes were not in place for most of FY 2009. The RRB has corrected a previously reported significant deficiency by implementing procedures for the periodic reconciliation of the general ledger to one of the non-integrated benefit payment systems; however, the lack of such procedures for other non-integrated transaction flows has been identified as a material weakness in the current fiscal year.

Our internal control work would not necessarily disclose all deficiencies in internal control that might be material weaknesses or other significant deficiencies. Although not considered to be material weaknesses or significant deficiencies, we will report other matters involving internal control and its operation to RRB management in a separate letter.

---

<sup>1</sup> The definition of internal control as it relates to the basic financial statements is presented in the footnotes on page 6.

<sup>2</sup> A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles (GAAP) such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

## **Material Weaknesses**

### Information Security

During FY 2009 the OIG evaluated the RRB's information security program pursuant to the provisions of the Federal Information Security Management Act (FISMA).<sup>3</sup> OIG auditors concluded that although the RRB has implemented all nine program elements required by FISMA and made notable progress in addressing previously cited deficiencies, the security program, as a whole, remains undermined by weaknesses in access control and controls over the certification and accreditation process.

RRB information technology managers are working to address the remaining weaknesses.

### Financial Reporting

RRB financial managers have worked to strengthen internal control over financial reporting during FY 2009. During the third quarter of FY 2009 the agency implemented enhanced controls to address the weaknesses that, in the aggregate, were the basis for the OIG's assessment of a material weakness during the prior year.<sup>4</sup> However, because these enhanced controls were not implemented until mid-year, they could not be relied upon to ensure the accuracy of accounting and reporting for FY 2009 and had not been in operation for a period of time sufficient to support an assessment of overall effectiveness.

RRB financial managers have expressed their commitment to a quality financial reporting process and have been responsive to OIG recommendations.

### Internal Control Over Non-Integrated Sub-Systems

Internal controls do not ensure the completeness of transactions originating in non-integrated subsystems.

An organization's financial statements are presented with management's implicit assertion that all transactions and other events and circumstances that occurred during a specific period and that should have been recognized in that period have, in fact, been recorded (completeness) and that liability, revenue, and expense components are recorded at appropriate amounts (accuracy, valuation, allocation).

---

<sup>3</sup> "Fiscal Year 2009 Evaluation of Information Security at the Railroad Retirement Board," OIG Report No. 10-01, November 12, 2009.

<sup>4</sup> "Fiscal Year 2008 Financial Statement Audit Letter to Management," OIG Report No. 09-02, March 2009.

The RRB's financial reporting structure relies on an automated general ledger which receives information electronically from both integrated and non-integrated subsystems that support transaction processing. The RRB's control structure is not comprehensive with respect to the reconciliation of the general ledger to non-integrated subsystems. As a result, errors in intermediary manual processes may occur and go undetected indefinitely.

The OIG has previously recommended that the RRB perform reconciliations of activity originating in non-integrated benefit payment subsystems. We also brought this issue to management's attention in connection with our audits of agency financial statements for FYs 2000, 2001 and 2008. Although financial managers recently implemented a reconciliation process for one major subsystem, the current reconciliation process is not comprehensive with respect to all such systems and transaction flows.

RRB financial managers are receptive to evaluating the feasibility of implementing an expanded program of reconciliations with the understanding that such a program will require extensive cross-organizational coordination and cooperation. They have agreed to study the matter, together with program managers, in order to identify a solution that provides for a comprehensive reconciliation process with adequate separation of duties.

## **COMPLIANCE WITH LAWS AND REGULATIONS**

Our tests of the RRB's compliance with selected provisions of laws and regulations for FY 2009 disclosed no instances of non-compliance that are reportable under U.S. generally accepted government auditing standards or OMB guidance. However, the objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

## **CONSISTENCY OF OTHER INFORMATION**

The RRB's Management Discussion and Analysis, required supplementary information, and other accompanying information contain a wide range of data, some of which are not directly related to the financial statements. We do not express an opinion on this information. However, we compared this information for consistency with the financial statements and discussed the methods of measurement and presentation with RRB officials. On the basis of this limited work, we found no material inconsistencies with the financial statements, U.S. generally accepted accounting principles, or with OMB guidance.

## OBJECTIVES, SCOPE, AND METHODOLOGY

RRB management is responsible for (1) preparing the financial statements in conformity with U.S. generally accepted accounting principles, (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA) are met, and (3) complying with applicable laws and regulations.<sup>5</sup>

We are responsible for obtaining reasonable assurance about whether the financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles. We are also responsible for (1) obtaining a sufficient understanding of internal control over financial reporting and compliance to plan the audit, (2) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements, and laws for which OMB audit guidance requires testing; and (3) performing limited procedures with respect to certain other information appearing in the RRB's Performance and Accountability Report. In order to fulfill these responsibilities, we:

- examined, on a test basis, evidence supporting the amounts and disclosures in the proprietary and budgetary financial statements;
- assessed the accounting principles used and significant estimates made by RRB management in preparing the proprietary and budgetary financial statements;
- assessed the factors, data, assumptions and model used by RRB management to prepare the long-term actuarial projections presented in the statement of social insurance;
- evaluated the overall presentation of the financial statements;
- obtained an understanding of the entity and its operations, including its internal control related to financial reporting, compliance with laws and regulations (including execution of transactions in accordance with budget authority);
- tested relevant internal controls over financial reporting and compliance, and evaluated the design and operating effectiveness of internal control;

---

<sup>5</sup>**Internal Control** as it relates to the financial statements is a process, affected by the agency's management and other personnel, designed to provide reasonable assurance that the following objectives are met: (1) Reliability of financial reporting - transactions are properly recorded, processed, and summarized to permit the preparation of the Basic Statements in accordance with generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) Compliance with applicable laws, regulations, and government-wide policies - transactions are executed in accordance with laws governing the use of budget authority, government-wide policies, and laws identified by OMB, and other laws and regulations that could have a *direct and material effect on the Basic Statements*.

- considered the design of the process for evaluating and reporting on internal control and financial management systems under the FMFIA; and
- performed tests of compliance with selected provisions of laws and regulations, including laws governing the use of budget authority, and other laws and regulations that could have a direct and material effect on the RRB's basic financial statements:
  - Anti-Deficiency Act, as amended;
  - provisions of the Railroad Retirement Act governing financing and the payment of benefits;
  - provisions of the Railroad Unemployment Insurance Act governing financing and the payment of benefits; and
  - provisions of the Social Security Act that provide for certification of benefits to the RRB for payment (42 U.S.C. § 405(i)).

We considered the material weaknesses identified above in determining the nature, timing, and extent of our audit procedures on the 2009 financial statements.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by the FMFIA, such as controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected by our audit. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. We also caution that our internal control testing may not be sufficient for other purposes.

We did not test compliance with all laws and regulations applicable to the RRB. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on the RRB's financial statements and those required by OMB audit guidance that we deemed applicable to the RRB's financial statements for the fiscal year ended September 30, 2009. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

The NRRIT was established pursuant to the Railroad Retirement and Survivors' Improvement Act of 2001 (Public Law 107-90). Under that law, the NRRIT is not a department, agency or instrumentality of the Government of the United States. In addition, the law specifically exempts the NRRIT from compliance with Title 31, United States Code which governs the monetary and financial operations of

the Federal government. The law also provides that the NRRIT annually engage an independent, qualified public accountant to audit the financial statements of the NRRIT. Accordingly, the OIG has not audited the books and records of the NRRIT, nor had any input into the selection of the independent accountant retained by the NRRIT, nor provided oversight to that firm in the execution of their responsibilities. Our opinion on the RRB's financial statements, insofar as it relates to the amounts included for the NRRIT, is based solely on the report of the auditor retained by the NRRIT, and our assessments of internal control and compliance do not extend to the operations of the NRRIT.

Except to the extent that the foregoing arrangement may have affected the planning and execution of our audit, we performed our work in accordance with U.S. generally accepted government auditing standards and OMB audit guidance.

### **RRB MANAGEMENT'S COMMENTS**

RRB management thanked the OIG audit staff for their close cooperative effort in meeting this year's financial reporting deadline. With respect to the material weaknesses described in this report, management cited their ongoing effort to strengthen controls over information security and financial reporting and their commitment to address weaknesses identified by the OIG. They also expressed their willingness to study the reported weakness in controls over non-integrated subsystems in order to identify a solution.

The full text of management's response follows as an attachment to this report. We did not perform audit procedures on the RRB's written response to the material weaknesses and, accordingly, we express no opinion on the response.

Original signed by:

Martin J. Dickman  
Inspector General

November 9, 2009, except for matters relating to  
the fair value of the net assets of the NRRIT as of  
September 30, 2009, as to which the date is  
November 16, 2009.



UNITED STATES GOVERNMENT

**MEMORANDUM**

RAILROAD RETIREMENT BOARD

**NOV 16 2009**

**TO :** Letty Benjamin Jay  
Assistant Inspector General for Audit

**FROM :** Kenneth P. Boehne  
Chief Financial Officer

**SUBJECT:** FY 2009 Financial Statement Audit – Auditor’s Report;  
Re: Your memorandum dated November 13, 2009

Original signed by:

My office, and those of the Board Members, have reviewed the Office of Inspector General’s draft report and have the following comments.

You reported material weaknesses in your draft report dealing with information security, financial reporting, and internal controls over non-integrated subsystems. The Railroad Retirement Board continues to recognize that information security is a significant challenge. We have devoted substantial effort and resources to correct weaknesses in the agency’s information security program. We will continue to do so in order to address the weaknesses identified by the Office of Inspector General. Regarding the financial reporting weakness, we have worked to strengthen internal control over financial reporting during fiscal year 2009 and have implemented enhanced controls to improve the agency’s financial accounting and reporting processes. We are committed to a quality financial reporting process and will continue to be responsive to any additional potential improvements that are identified. Concerning the reported weakness in internal controls over non-integrated subsystems, agency financial managers and program managers will continue to study the matter in order to identify a solution that provides for a comprehensive reconciliation process with adequate separation of duties.

We again thank you and your staff for working closely and cooperatively with us these past few months to help ensure that the RRB will be able to meet this year’s reporting deadline of November 16, 2009.

cc: The Board  
Executive Committee

***PAGE INTENTIONALLY LEFT BLANK***